No. 80-580

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JAMES FRANCIS O'HARA, III, MICHAEL PATRICKS O'HARA, INDIVIDUALLY AND AS GUARDIANS OF THE PROPERTY OF JOSEPHINE M. O'HARA,

Petitioners,

v.

IRVIN KOVENS, MARVIN MANDEL, W. DALE HESS, EARNEST N. CORY, JR., EUGENE B. CASEY, IRVING T. SCHWARTZ,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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The Respondents, Irvin Kovens, Marvin Mandel, W. Dale Hess, Ernest N. Cory, Jr., Eugene B. Casey, and Irving T. Schwartz, respectfully request that this Court deny the petition for writ of certiorari, seeking review of the judgment of the United States Court of Appeals for the Fourth Circuit, in this case. The opinion of the Court of Appeals for the Fourth Circuit is reported at 625 F.2d 15 (4th Cir. 1980).

STATEMENT OF THE CASE

The Petitioners are James Francis O'Hara and Michael Patrick O'Hara, individually and as guardians of the

property of their mother, Josephine M. O'Hara. Their petition seeks to review the Fourth Circuit's affirmation of an order entered in the United States District Court for the District of Maryland, by Judge Joseph H. Young, dismissing a private action for alleged securities fraud.

The O'Haras are three of the former stockholders of Marlboro Racetrack. Their action, filed on November 22, 1978, sought damages for fraud allegedly practiced upon them in connection with the December, 1971 sale of their stock. James and Michael, who had been guardians of Josephine's property for two years, since November 22, 1976, claimed that they discovered the alleged fraud on November 25, 1975, almost three years before instituting suit.

The complaint was in three counts. The first count, founded on a federal cause of action, alleged that the conduct of the defendants was in violation of Section 10(b) of the Securities Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The second count asserted that the defendants' actions amounted to a "violation of the Maryland Securities Act," and the third count alleged that they constituted "common law fraud". Jurisdiction of the second and third counts, based entirely on State causes of action, was claimed "under the doctrine of pendent jurisdiction".

Simultaneously with the filing of the federal action, the O'Haras filed suit in the Superior Court of Baltimore City. The declaration in the State case contains two counts which are identical to the second and third counts of the complaint in the federal action. By agreement of counsel, further proceedings in the State case were stayed until the resolution of the present case. Since the federal complaint was dismissed, the plaintiffs have been free to proceed with their case in the State court.

The complaint alleged that the defendants initiated a fraudulent scheme "at some point, between January 7, 1969 and May 28, 1971;" that, in 1971, they secretly and deceptively acted to depress the value of the plaintiffs' stock; that the plaintiffs "sold their stock on or about December 31, 1971;" and that, in 1972, after purchasing "the controlling interest in Marlboro," the defendants acted, partly in secret, to increase the value of the stock "theretofore fraudulently acquired from the plaintiffs." It was also alleged that the plaintiffs "began learning and discovering" the alleged fraud on November 24, 1975, almost three years before this action was filed, when the defendants were indicted "by the federal grand jury" in the District of Maryland.

On July 16, 1979, the District Judge granted motions for dismissal and for judgment on the pleadings. In a written opinion, he held that the federal claim under Section 10(b) and Rule 10b-5 was subject to the one-year limitations period of the Maryland blue sky law, and, that the action, not brought until nearly three years after the discovery of the alleged fraud, therefore was barred (by limitations.) 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. The state claims, asserted only by way of pendent jurisdiction, were dismissed as well. *See, O'Hara v. Kovens,* 473 F. Supp. 1161 (D. Md. 1979), (Pet. App. 1a).

Following oral argument, the United States Court of Appeals for the Fourth Circuit affirmed the dismissal. *See O'Hara v. Kovens,* 625 F.2d 15 (4th Cir. 1980) (Pet. App. 13a)

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

I.

REVIEW IS UNNECESSARY SINCE THERE ALREADY EXIST UNIFORM GUIDELINES FOR FIXING A PERIOD OF LIMITATIONS FOR IMPLIED CAUSES OF ACTION ARISING UNDER THE FEDERAL SECURITY STATUTES.

The Petitioners' federal claims are based on the implied right of action arising under Section 10(b) of the Securities & Exchange Act of 1934. *See, Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975).

Although the Securities & Exchange Act of 1934 contains express limitations periods for causes arising under various sections thereunder, it is settled law, not challenged by Petitioners, that these express limitation provisions do not govern the right of action implied under Section 10(b) of the Act. *See, Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 210 n. 29 (1976). Similarly, it is also settled law, not challenged by Petitioners, that federal courts must fix, as a matter of federal common law, a period of limitations for suits based on Section 10(b) of the federal securities laws. *Ernst & Ernst, supra.*

Finally, it is a basic rule, equally well settled and not challenged by Petitioners, that a federal court must apply the period which the forum State applies to a State cause of action bearing the closest substantive resemblance to the implied cause of action arising under the federal securities laws. *Id.* Every circuit has adopted and applies this rule. *See, e.g., Vanderboom v. Sexton,* 422 F.2d 1233 (8th Cir. 1970); *Mitchell v. Texas Gulf Sulphur Co.,* 446 F.2d 90 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971), *reh. denied,* 404 U.S. 1064 (1972); *Parrent v. Midwest Rug Mills, Inc.,* 455 F.2d 123 (7th Cir. 1972); *United California Bank v. Salik,* 481 F.2d 1012, (9th Cir. 1973), *cert. denied,* 414 U.S. 1004 (1974); *Nickels v. Koehler Management*

Corp., 541 F.2d 611 (6th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977); *Stull v. Bayard*, 561 F.2d 429 (2nd Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); *Forrestal Village, Inc. v. Graham*, 551 F.2d 411 (D.C. Cir. 1977); *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888 (5th Cir. 1979); *Roberts v. Magnetic Metals Co.*, 611 F.2d 450 (3rd Cir. 1979); *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978).

Despite the universal acceptance of these basic and well settled rules of law, Petitioners suggest that there is a conflict among the circuit courts by reason of "inconsistent interpretations by different federal courts of the same body of federal law". Pet. at 10. To support this proposition, Petitioners misconstrue the cases upon which they rely.

First, Petitioners find evidence of such a conflict among the circuits by quoting Judge McCree's opinion in *Nickels v. Koehler Management Corp., supra,* to the effect that there exists an "anomaly of applying different limitations period to plaintiffs who purchased or sold the same security but resided in different states." *Id* at 614.

It is true the such an "anomoly" exists, but it is inherent in the very nature of the federal "borrowing" rule. Even if every circuit chose the forum State's general fraud statute as the limitations period for Section 10(b) actions, nevertheless the limitations periods applied to cases arising in different states would vary enormously. Thus, residents of Massachusetts would have but two years in which to bring suit, *see, Cook v. Avien, Inc., supra;* while residents of Arkansas, California, District of Columbia and Utah would have three years, *see, Vanderboom v. Sexton, supra* (Ark.), *United California Bank v. Salik, supra* (Cal.); *Forrestal Village, Inc. v. Graham, supra* (D.C.); *Mitchell v. Texas Gulf Sulphur Co., supra* (Utah); and residents of Georgia and Ohio would have four years in which to file suit, *see, McNeal v. Paine, Webber, Jackson & Curtis, Inc.,*

supra (Ga.); *Nickels v. Koehler Management Corp., supra* (Ohio); while residents of Illinois would have five years in which to file suit, *see, Parrent v. Midwest Rug Mills, Inc., supra;* and, finally, residents of New York and New Jersey would have six years in which to file suit, *see, Stull v. Bayard, supra* (N.Y.); and *Roberts v. Magnetic Metals Co., supra* (N.J.). Similarly, even if every circuit chose the forum State's blue sky statute as the appropriate limitations period, the actual periods would encompass periods of one year, *O'Hara v. Kovens, supra* (Md.); or two years, *Vanderboom v. Sexton, supra* (Ark.); or three years, *Parrent v. Midwest Rug Mills, Inc., supra* (Ill.); or four years, *United California Bank v. Salik* (Cal.).

The point is simple. Regardless of the statute of the forum State chosen as a basis for fixing federal limitations in Section 10(b) actions, the limitations period would nevertheless vary from circuit to circuit and from State to State by as much as four years. This variation is endemic in the settled rule that the federal courts must supply a limitations period by borrowing from an analogous period chosen by the forum State. Obviously, since different States have fixed different limitations periods for similar causes of action, the rule necessarily results in different terms of years being applied by federal courts to similar cases. However, this variation among circuits is no evidence of a "conflict" among circuits. Indeed, this variation is evidence of harmony among the circuits since they are all applying the same rule to different local circumstances, which application necessarily yields a difference in result.

The only solution to such differences would be for the Congress to fix and determine a definite period of limitations which would apply to all implied causes of action arising under Section 10(b), regardless of where they are filed. Such a change of governing law, not

requested by Petitioners, would be inappropriate for the Court to undertake.

The sources of the rule requiring resort to State law are early decisions of this Court holding that State statutes of limitations generally govern the timeliness of federal causes of action unless Congress has specifically provided otherwise. *Campbell v. City of Haverhill.* 155 U.S. 610 (1895); *McCluny v. Silliman,* 28 U.S. (3 Pet.) 270 (1830). *See generally,* Hill, *State Procedural Law in Federal Non-Diversity Litigation,* 69 Harv. L. Rev. 66, 79-80 (1955). These early cases recognize that fixing limitations periods for different types of actions is a task uniquely suited to a legislative body. More recently, in a suit upon a collective bargaining contract under Section 301 of the Labor Management Relations Act of 1947, 29 U.S.C. § 185, this Court rejected the claim that it devise a uniform time limitation and instead applied a State statute of limitations, with the comment that "the teaching of our cases does not require so bald a form of judicial innovation." *International Union v. Hoosier Cardinal Corp.,* 383 U.S. 696, 701 (1966). This Court further stated:

> "Thus, although a uniform limitations provision for § 301 suits might well constitute a desireable statutory addition, there is no justification for the drastic sort of judicial legislation that is urged upon us." *Id.* at 702-03.

There have, of course, been proposals for legislation to solve the problem of different time periods applying to Section 10(b) suits, if problem it be. For example, the American Law Institute has proposed a recodification of the federal securities laws which would contain a uniform federal statute of limitations applicable to all claims, expressed and implied, arising under the securities laws. *See,* A.L.I., *Federal Securities Code, proposed official draft,* Section 1727 (March 15, 1978). Congress has yet to adopt the A.L.I. recommendation, and until it does so, especially

in view of the fact that the Petitioners do not urge any different course, this Court ought leave undisturbed the well settled and universally accepted rule of borrowing in Section 10(b) cases.

Even though Petitioners do not seek to have the borrowing rule changed, they suggest that the "difficulties inherent in this choice have plunged the circuits into a morass of inconsistent and irreconcilable decisions". Pet. at 15. Aside from pointing out the different periods of time selected by different circuits in different cases, Petitioners also suggest that there is a conflict among circuits because some circuits have chosen the period of limitations contained in a forum State's blue sky laws while others have chosen some other period of limitations.

Once again, this variation is not a function of any conflict in accepting or applying governing principles of law. It simply reflects the fact that local laws do differ from each other. While one cause of action pursuant to one state's blue sky Law may closely resemble a Section 10(b) cause of action, a cause of action under another state's blue sky Law may be so restricted (or expanded) in coverage as to offer no analogy to Section 10(b). Similarly, one State may have a particular statute of limitations governing a common law fraud action which is closely analogous to a Section 10(b) action while another State may have a common law rule of fraud which is too restrictive (or expanded) to be considered a match.

Ultimately, the choice must be made on a case-by-case basis, by comparison of (1) the particular allegations of the federal complaint, (2) the forum State's blue sky statue, where the State has a blue sky statute, (3) the forum State's common law rules of fraud, (4) the forum State's statute of limitations, if any, specifically applicable to common law fraud, and (5) the forum State's other available statute of limitations. Given these variables, it is

to be expected that actual results will vary from circuit to circuit and even within the same circuit, in cases arising from different states.

For example, Petitioners suggest that the Fifth Circuit's opinion in *McNeal v. Paine, Webber, Jackson & Curtis, Inc., supra,* demonstrates that the Fifth Circuit's borrowing rule is "in a state of flux". Pet. at p. 10. It is true that *McNeal* applies Georgia's "fraud" statute of limitations to a Section 10(b) cause of action, and that the Fifth Circuit had earlier applied Florida's blue sky law to a Rule 10(b)-5 cause of action in *Hudak v. Economic Research Analysts, Inc.,* 499 F.2d 996 (5th Cir. 1974). Because of these different results, Petitioners suggest that the *McNeal* case is inconsistent with *Hudak.*

Hudak and *McNeal* are not inconsistent. They reach different results because the Florida and Georgia statutes differ from one another and because the complaints in both cases also differ. As explained by the Fifth Circuit in *McNeal*:

> "Although the language of Section 11 of the Georgia Securities Act of 1957 mimics that of Rule 10(b)-5 . . . the remedy made available by Section 13 is expressly limited to an action for rescission. . . . Any similarity between the damages remedy available to [the Plaintiff] under section 10(b) and the rescission remedy available under the Georgia Securities Act of 1957 is therefore, at best, uncertain. By contrast, there is no reason to doubt that Georgia's general fraud statute would support an action for money damages based on the churning of [Plaintiff's] account. . . . Hence, we conclude that the cause of action available under the general fraud statute more closely resembles [Plaintiff's] cause of action under section (10b) than that available under the Georgia Securities Act of 1957. . . .
>
> In so holding, we distinguish the prior decision of this court in *Hudak v. Economic Research Analysts,*

> *Inc.* . . . In that case, the plaintiff sought to return the purchase price of worthless securities bought for him by a broker who converted the plaintiff's funds to his own use. The court concluded the cause of action available under the Florida sale of securities law (identical, for practical purposes, to the Georgia Securities Act of 1957) more closely resembled the plaintiff's cause of action under section (10b) than did the cause of action available under the Florida general fraud statute. The court stressed, however, 'the congruence between the specific remedy sought here — return of the purchase money — and the remedy of rescission for which Florida securities law provides a two-year statute.'" (citations omitted)

Id. at 894.

It is clear, therefore, that the Fifth Circuit found the results in both cases to be in harmony with each other, and, in fact, they are. The simple fact of the matter is that the factual allegations of both complaints differed from one another, as did the particular security statutes involved. Hence, one would expect, as was the case, that different results would be reached.

The Petitioners fail to point out that in most of the cases in which a particular circuit chose the forum State's fraud statute of limitations, that particular forum State had a general fraud statute which contained its own statute of limitations.

By contrast, Maryland has no fraud statute nor does it have a special statute of limitations which applies only to fraud actions. The choice in the present case was between the limitations statute in Maryland's blue sky law, which was applied by the courts below, or the three-year catch all provision applicable generally to civil actions at law, Md. Cts. & Jud. Proc. Code Ann., Section 5-101. The catch-all provision, Section 5-101, applies to contracts as well as torts, to actions of negligence as well as those of intention-

al wrong, and even to cases involving liability without fault. As between the two available Maryland statutes the limitations provision of the blue sky law, tailored specially to securities transactions, was a more appropritate choice, whatever might be the case with respect to other states.

In summary, the decision below is clearly correct with respect to its application of Maryland law and it is consistent with the decisions recorded in similar decisions in other circuits.

II.

THE COURTS BELOW PROPERLY HELD THAT THE STATUTE OF LIMITATIONS WAS NOT TOLLED BY REASON OF MRS. O'HARA'S MENTAL INCOMPETENCY.

James and Michael O'Hara have been guardians of Josephine O'Hara's property since November 22, 1976. They claim that they discovered the alleged fraud on November 25, 1975. This suit was instituted on November 22, 1978. The question is whether the courts below were correct in holding that the cause of action accrued not later than November 22, 1976, the date upon which they were appointed as guardians, almost one full year after discovery of the alleged fraud.

The Petitioners suggest that a statute of limitations will never run against a mental incompetent until the disability is removed regardless of whether or not a guardian of the incompetent's property has been appointed. Because the lower courts found no support for such a proposition in either Maryland law or in federal equitable principles, Petitioners seek certiorari in this Court.

Petitioners' position is fundamentally wrong. The Court of Appeals was guided, as Petitioners concede, by *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454 (1975). The Court of Appeals decision was entirely consistent with the

recent case of *Board of Regents v. Tomiano*, ___ U.S. ___, 48 U.S.L.lW. 4556 (May 19, 1980), 100 S. Ct. 1790 (1980). Both *Johnson* and *Tomiano* hold that where State law is borrowed for a limitations period, State law should also furnish the grounds for tolling and other ancillary provisions of limitations, except where inconsistent with the federal policy underlying the cause of action under consideration. As this Court pointed out in *Tomiano*, "a state statute cannot be considered inconsistent with federal law merely because the statute causes the plaintiff to lose the lititgation." *Id.* at 1797.

As the Court of Appeals properly concluded, Maryland's blue sky law makes no provision for tolling on grounds of incompetency. Equally correct is the Court of Appeals' decision that there are no federal equitable grounds for engrafting such a provision onto the Maryland Code. Indeed, federal law does not allow limitations periods to be tolled by mental incompetency. *Accardi v. United States*, 435 F.2d 1239, 1241 n.2 (3d Cir. 1970); *Casias v. United States*, 532 F.2d 1339 (10th Cir. 1976); *Williams v. United States*, 228 F.2d 129, 132 (4th Cir. 1955).

Not only is the result below consistent with Maryland law and with well accepted federal law, but it is also consistent with the policies underlying the federal securities statutes. It would be incongruous in the extreme to grant a plaintiff a perpetual cause of action for securities fraud. Where no limitations period is included in a federal statute "both state and federal courts have applied the state law of limitations, in the belief that Congress would not have intended the anomaly of a class of perpetual rights." *Developments in the Law — Statutes of Limitations*, 63 Harv. L. Rev. 1177, 1266 (1950). Since the underlying purpose of the securities acts is to facilitate reliability in the capital formation markets of the United States, it would hardly serve that purpose by excluding,

forever, the period of time in which the guardians of incompetents may "sit on their rights" before filing suit.

III.

THE DECISIONS BELOW WERE CONSISTENT WITH THIS COURT'S DECISION IN *ERNST & ERNST V. HOCHFELDER*.

The Court in *Ernst & Ernst, supra,* held that Section 10(b) incorporates a requirement that scienter be proven before liability in a private cause of action may be imposed. In so holding, this Court made reference to, and approved, the principle of "borrowing" an anlogous State court period of limitations to be applied in a Section 10(b) action in federal court. 425 U.S. at 210, n. 29. Despite Petitioners' contentions to the contrary, the Court did not suggest that the borrowing concept was improper in *Ernst & Ernst* nor did it express any disagreement therewith.

The suggestion, therefore, that *Ernst & Ernst* "justifies" an out-of-hand rejection of a one-year limitations period as being too short to impose upon a cause of action under Section 10(b) is simply without support.

CONCLUSION

For these reasons, Respondents respectfully request that the Petition for Certiorari be denied.

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